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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION TWO

In re TRANSIENT OCCUPANCY TAX CASES	B236166 (Los Angeles County Super. Ct. No. SC0108568; JCCP No. 4472)

APPEAL from a judgment of the Superior Court of Los Angeles County. Carolyn B. Kuhl and Elihu M. Berle, Judges. Affirmed.

Kiesel Boucher Larson, William L. Larson and Shehnaz M. Bhujwala; Baron & Budd, Laura J. Baughman and Thomas M. Sims; City of Santa Monica City Attorney's Office, Marsha Jones Moutrie, Joseph P. Lawrence, and Roger C. Rees for Plaintiff and Appellant City of Santa Monica.

Skadden, Arps, Slate, Meagher & Flom, Darrel J. Hieber, Stacy R. Horth-Neubert, and Daniel M. Rygorsky for Defendants and Respondents Priceline.com Incorporated, Lowestfare.com LLC, and Travelweb LLC.

Jones Day and Brian D. Hershman for Defendants and Respondents Expedia, Inc., Hotwire, Inc., Travelnow.com, Hotels.com, L.P., and Hotels.com GP, LLC.

Kelly Hart & Hallman, Brian S. Stanger and Chad Arnette for Defendants and Respondents Travelocity.com LP, Travelocity.com, Inc., and Site59.com LLC.

McDermott Will & Emery and Jeffrey A. Rossman for Defendants and Respondents Orbitz, LLC, Cheaptickets.com, and Lodging.com.

In June 2010, the City of Santa Monica (the city) assessed transient occupancy taxes (TOT) against respondents, who are online travel service companies (OTCs).[1] After the OTCs failed to pay the assessments, the city filed this action seeking to enforce the assessments. The city also asserted claims for conversion, violation of California Civil Code sections 2223, 2224, 2349, and 2351, imposition of constructive trust, breach of fiduciary duty, fraudulent concealment, money had and received, and unjust enrichment. The OTCs demurred to the city's amended complaint (AC), and the trial court sustained the OTCs' demurrer without leave to amend. A judgment dismissing the matter with prejudice was entered on July 26, 2011. The city appeals.

We find that the OTCs are not liable for TOT under the plain language of the city's TOT ordinance, therefore we affirm the trial court's ruling.

FACTS

The city's TOT ordinance

The city's TOT ordinance imposes "on each and every transient a tax equivalent to fourteen percent (14%) of the total amount paid for room rental by or for any such transient to any hotel." (Santa Monica Mun. Code, § 6.68.020.)[2]

"Transient" is defined as "[a]ny person who, for any period of not more than one month either at his own expense or at the expense of another, obtains lodging or the use of any lodging space in any hotel as hereinafter defined, for which lodging or use of lodging space a charge is made." (§ 6.68.010, subd. (a).)

"Hotel" is defined as "[a]ny public or private hotel, inn, hostelry, tourist home or house motel, rooming house or other lodging place within the City of Santa Monica

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[1] The OTCs are the following entities: (i) Expedia entities: Expedia, Inc., Hotwire, Inc., Travelnow.com, Hotels.com, L.P., Hotels.com GP, LLC; (ii) Priceline entities: Priceline.com Inc., Travelweb LLC, Lowestfare.com LLC; (iii) Orbitz entities: Orbitz, LLC, Trip Network, Inc. (doing business as Cheaptickets.com), Internet Publishing Corp. (doing business as Lodging.com); and (iv) Travelocity entities: Travelocity.com LP, Travelocity.com, Inc. (now known as Travelocity.com LLC), Site59.com LLC.

[2] All further section references are to the Santa Monica Municipal Code, unless otherwise noted.

offering lodging, wherein the owner and operator thereof, for compensation, furnishes lodging to any transient as hereinabove defined." (§ 6.68.010, subd. (c).)

"Room rental" is defined as "[t]he total charge made by any such hotel for lodging and/or lodging space furnished any such transient. If the charge made by such hotel to such transient includes any charge for services or accommodations in addition to that of lodging, and/or the use of lodging space, then such portion of the total charge as represents only room and/or lodging space rental shall be distinctly set out and billed to such transient by such hotel as a separate item." (§ 6.68.010, subd. (d).)

OTCs

OTCs are online travel service companies that publish comparative information about airlines, hotels and rental car companies on their websites, and allow customers to book reservations with such travel providers. OTCs do not possess or operate any airlines, hotels or rental car companies. Instead, as explained in the AC:

> "The OTCs maintain their own businesses; they are paid according to the results they produce and consistent with their contracts with the hotels. On behalf of various City hotels, the OTCs sell nightly lodging licenses provided by the hotels. The OTCs are paid percentage commissions from the total amount [transients] pay to purchase these lodging licenses. The OTCs' contracts with the hotels dictate the nature, amount and timing of the OTCs' compensation."

Further, the OTCs are not product resellers; the OTCs never obtain or purchase the right to occupy a hotel room for resale to transients. In sum, according to the AC, the OTCs "are one of many types of travel intermediaries that provide indirect electronic distribution of hotel lodging licenses."

The OTCs use three primary business models: the agency model, the modified merchant model, and the preferred merchant model.

Under the agency model, the OTCs are paid a commission the same way that travel agents historically have been paid. The OTC makes a room reservation for a customer. The customer pays the hotel directly both for the price of the hotel room and

the TOT based on the total charge for the room rental. The OTCs' commission is taken out of the total charge for the room rental.

Under the modified merchant model, OTCs are authorized by hotels to act as merchants of record for room rentals. The OTCs collect all sums from the transients, then forward all such sums to the hotels. The hotels then pay the OTCs commissions based on the total charge for the room rental. The OTCs' commission is part of the total charge for the room rental.

The OTCs' preferred merchant model is similar to the modified merchant model in that the OTCs are authorized by the hotels to rent rooms to transients and act as merchants of record for these transactions. The OTCs collect all sums from transients, but then retain their sales commission plus an amount equal to TOT on their sales commission before forwarding to the hotel the remaining amounts. It is the preferred merchant model that is at issue in the city's AC. The city alleged that:

> "After the sale of a lodging license to a transient under the OTCs' preferred merchant model, an OTC collects all funds from the transient and extracts its sales commission before passing the remaining money to the hotel. In addition to collecting and retaining its sales commission, the OTC collects and retains TOT on the value of this sales commission. The hotel only receives TOT for remittance to the City based upon a portion of rather than the total charge for lodging. The city is underpaid TOT because the OTCs keep TOT on the value of their services. This is the source of the principal damages in this action."

PROCEDURAL HISTORY

The TOT assessments and the complaint

Pursuant to the city's TOT ordinance, the city assessed the OTCs for back TOT and penalties for the period January 1, 2000 to June 1, 2010. After the OTCs failed to pay the assessments, the city brought an action against the OTCs to enforce them. The operative complaint was the AC, filed on September 16, 2010. The AC alleged causes of action for: (1) violation of the City of Santa Monica Municipal Code; (2) money had and received; (3) conversion; (4) declaratory relief; (5) violations of Civil Code section 2223; (6) violations of Civil Code section 2224; (7) imposition of constructive trust; (8)

declaratory relief regarding application of the step transaction doctrine; (9) agent liability under Civil Code sections 2343 and 2344; and (10) subagent liability under Civil Code sections 2349 and 2351.

The city's action was coordinated with similar actions brought by the cities of Anaheim, San Diego, and other municipalities.

The OTCs' demurrer

On October 8, 2010, the OTCs filed a joint demurrer, arguing that each of the city's causes of action failed as a matter of law. On March 16, 2011, after briefing and argument, the trial court issued its opinion and order on the joint demurrer.

The trial court noted that all of the city's causes of action "are premised on Santa Monica's interpretation of its transient occupancy tax as requiring payment of tax on the full amount an OTC charges a customer for a hotel room, even though the hotel that furnishes the room to the occupant does not receive the full amount of the payment made by the customer to the OTC."

The trial court then undertook an "exercise in statutory construction," beginning with the language imposing the tax. The court noted that the provision determines the amount of tax based on the room rental paid "to any hotel . . . ." (§ 6.68.020.) The court explained "[w]hether a transient pays a hotel directly, or a transient pays an intermediary which in turn pays room rental 'for' the transient, the tax is imposed on the 'total amount paid for room rental . . . to any hotel.'"

The trial court further considered the definition of the term "room rental," noting that the term was defined as the total amount charged "by any such hotel" for lodging furnished to the transient. The court concluded that the phrase "total charge made by [a] hotel" found in section 6.68.010, subdivision (d) must be construed to mean the charge that the hotel determines must be paid to the hotel. Thus, "the statute does not concern itself with whether the hotel exercises control over the price charged by reseller or intermediary; the tax is imposed on the amount received by the hotel."

The trial court also analyzed whether its construction of the ordinance was consistent with the apparent purpose of the ordinance. The court concluded that it was, stating:

> "The overall purpose of the transient occupancy tax is to raise revenue for the City of Santa Monica from a particular type of commercial activity taking place in Santa Monica. The tax is imposed only on a hotel or other lodging place physically located 'within the city of Santa Monica . . . .' (*Id.* section 6.68.010(c) (definition of 'hotel').) The tax 'is levied for revenue [purposes] and is necessary for the usual financial operation of the City of Santa Monica.' (*Id.* section 6.68.020.) In order to enforce the ordinance, it is the 'duty of the Director of Finance-City Controller to ascertain the name of every person operating a hotel in the City of Santa Monica' that is liable for the tax but fails to collect or pay the tax. (*Id.* section 6.68.120.)"

The trial court concluded that the tax is based "on the revenue of the commercial business that provides the local amenity."

The trial court rejected the city's argument that the step transaction doctrine should be applied to conclude that transients should be taxed on the total amount paid out by the transient. The court reasoned, "[t]he problem with this argument is that the language of the Santa Monica ordinance does not support an intention to impose tax on all amounts paid by the transient." Rather, it imposes a tax based on the amounts paid "to [a] hotel."

The trial court concluded that "the City has no right to collect transient occupancy taxes from the OTCs based on the factual allegations of the [AC]." The city did not contend that there were other facts that could be alleged. Therefore the demurrer was sustained in its entirety without leave to amend.

A final judgment of dismissal was filed on July 26, 2011. On September 20, 2011, the city filed its notice of appeal.

DISCUSSION

I. Standard of review

"On appeal from a judgment dismissing an action after sustaining a demurrer without leave to amend, the standard of review is well settled. The reviewing court gives the complaint a reasonable interpretation, and treats the demurrer as admitting all material facts properly pleaded. [Citations.] The court does not, however, assume the truth of contentions, deductions or conclusions of law. [Citation.] The judgment must be affirmed 'if any one of the several grounds of demurrer is well taken. [Citations.]' [Citation.] However, it is error for a trial court to sustain a demurrer when the plaintiff has stated a cause of action under any possible legal theory. [Citation.] And it is an abuse of discretion to sustain a demurrer without leave to amend if the plaintiff shows there is a reasonable possibility any defect identified by the defendant can be cured by amendment. [Citation.]" (*Aubry v. Tri-City Hospital Dist.* (1992) 2 Cal.4th 962, 966-967.) The legal sufficiency of the complaint is reviewed de novo. (*Montclair Parkowners Assn. v. City of Montclair* (1999) 76 Cal.App.4th 784, 790.)

II. Rules governing statutory construction

The survival of the city's claims against the OTCs turns on the interpretation of the TOT ordinance. Thus, our main task will be to interpret the ordinance.

The canons of statutory construction are well settled. The fundamental rule of statutory construction is that the court should ascertain the intent of the drafters so as to effectuate the purpose of the law. (*Select Base Materials v. Board of Equalization* (1959) 51 Cal.2d 640, 645 (*Select Base*).)

In determining the intent of the enacting body, we first examine the words of the statute itself. (*California Teachers Assn. v. San Diego Community College Dist.* (1981) 28 Cal.3d 692, 698 (*California Teachers*).) If the language of the statute is clear and unambiguous, there is no need for statutory construction. (*Lungren v. Deukmejian* (1988) 45 Cal.3d 727, 735.) However, "the 'plain meaning' rule does not prohibit a court from determining whether the literal meaning of a statute comports with its purpose . . . ." (*Ibid.*) "If . . . the terms of a statute provide no definitive answer, then courts may resort

to extrinsic sources, including the ostensible objects to be achieved and the legislative history. [Citation.]" (*People v. Coronado* (1995) 12 Cal.4th 145, 151.) Every statute should be construed "'with reference to the whole system of law of which it is a part so that all may be harmonized and have effect.' [Citation.]" (*Select Base, supra*, 51 Cal.2d at p. 645.) "'We must select the construction that comports most closely with the apparent intent of the [drafters], with a view to promoting rather than defeating the general purpose of the statute, and avoid an interpretation that would lead to absurd consequences.' [Citation.]" (*Coronado, supra,* at p. 151.) The purpose of the statute "will not be sacrificed to a literal construction" of any part of the statute. (*Select Base*, at p. 645.)

In interpreting tax statutes, we must find an express intent to impose a tax. The Supreme Court has declared:

> "In every case involving 'the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government, and in favor of the citizen.' [Citations.]"

(*Pioneer Express Co. v. Riley* (1930) 208 Cal. 677, 687.)

In sum, a taxing authority must be held to the express terms of a tax statute. (*Agnew v. State Bd. of Equalization* (1999) 21 Cal.4th 310, 327.)

III. The city's TOT ordinance

Our first task is to examine the words of the ordinance. (*California Teachers, supra*, 28 Cal.3d at p. 698.) The ordinance, which was enacted in 1963, provides:

> "On and after the effective date of this ordinance, there is hereby imposed and levied upon each and every transient a tax equivalent to fourteen percent (14%) of the total amount paid for room rental by or for any such transient to any hotel; which said tax shall be collected from such transient at the time and in the manner hereinafter provided. Said tax is levied for revenue purposes and is necessary for the usual financial operation of the City of Santa Monica." (§ 6.68.020.)

As set forth below, we find that the words of the statute are clear and unambiguous, and do not reveal an intent to tax commissions deducted by the OTCs.

A. The tax imposed by the statute does not include the OTCs' commissions as part of the tax base

The tax imposed by the city on the transient is expressly limited to "the total amount paid for room rental by or for any such transient to any hotel." (§ 6.68.020.) In ascertaining the meaning of this phrase, we look to the plain meaning of the words and their definitions.

First, the tax is only imposed on the amount paid by a transient "for room rental." "Room rental" is defined as "[t]he total charge made by [a] . . . hotel for lodging and/or lodging space furnished any such transient." (§ 6.68.010, subd. (d).) This language expressly limits the taxable amount to the charge made *by the hotel*. A "hotel" is defined as "[a]ny public or private hotel, inn, hostelry, tourist home or house motel, rooming house or other lodging place within the City of Santa Monica offering lodging, wherein the owner and operator thereof, for compensation, furnishes lodging to any transient as hereinabove defined." (§ 6.68.010, subd. (c).) As the city concedes, the OTCs do not own or operate any hotels within the city, nor do they furnish lodging to any transient. Thus, the OTCs' commissions are not included in the taxable amount under the plain language of the statute.

Further, the tax is limited to amounts paid for room rental by the transient "to any hotel." Thus, the taxable amount is limited to that money which is paid to a "lodging place within the City of Santa Monica." (§ 6.68.010, subd. (c).) Reading section 6.68.010, subdivision (d) together with section 6.68.010, subdivision (c), the taxable base is defined as both an amount charged *by* a hotel (§ 6.68.010, subd. (d)), and an amount paid *to* a hotel (§ 6.68.020). This clear language limits the taxable amount to the amount that the hotel itself charges and receives.

This interpretation makes sense and conforms with the purpose of the ordinance. The apparent purpose of the ordinance is "for revenue purposes" for the "financial operation of the City of Santa Monica." (§ 6.68.020.) The tax is limited to the amount

that a transient pays to a hotel located "within the City of Santa Monica." (§ 6.68.010, subd. (c).) The tax specifically targets commercial activity within the City of Santa Monica, for the purposes of raising revenue for the city. There is no stated or implied intention to tax amounts paid to intermediaries or travel agents.

The city claims that this interpretation ignores the ordinance's express statement of intent. The city focuses on the statute's intent to "impose[]" and "lev[y] on each and every transient a tax . . . ." (§ 6.68.020.) The city argues that these words show that the tax applies to the transient's purchase, and should therefore be interpreted to apply to the entire purchase amount paid at the time that the room is rented. In addition, the city points to the first sentence of section 6.68.040, captioned "Collection." The sentence reads, in pertinent part: "[E]very person receiving any payment for room rental with respect to which a tax is levied under this ordinance shall collect the amount of tax hereby imposed from the transient on whom the same is levied or from the person paying for such room rental, at the time payment for such room rental be made." The city suggests that this sentence provides that the TOT shall be collected from the transient at the same time that the transient pays the "room rental." In sum, the city's position is that the drafters of the ordinance intended to impose the TOT on the total amount paid by transients for lodging licenses.

The city's proposed interpretation ignores the plain language of the ordinance. As set forth above, the ordinance does impose tax on a transient, but that tax is specifically limited to amounts paid by the transient *to the hotel for room rental.* The definition of "hotel" is clear: it is a "lodging place within the City of Santa Monica." (§ 6.68.010, subd. (c).) Contrary to the city's argument, the ordinance does not show intent to impose TOT on all amounts paid by the transient. We find that the ordinance does not suggest an intention to apply TOT to amounts paid to, or charged by, an OTC or any entity other than a hotel located within the boundaries of the city.

B. The statute provides for the possibility of intermediary transactions

The city argues that the ordinance does not incorporate or accommodate intermediary transactions such as those carried out by the OTCs. The focus of this

argument is the language in the statute imposing the tax on "the total amount paid for room rental *by or for* any such transient to any hotel." (§ 6.68.020, italics added.) The trial court concluded that, through this language, "the ordinance contemplates that there may be an intermediary in the transaction between the transient and the hotel." Thus, whether the transient pays a hotel directly, or whether a transient pays an intermediary which in turn pays the hotel, the tax is limited to "the total amount paid for room rental . . . to any hotel." (§ 6.68.020.)

The city takes issue with this conclusion. First, the city argues, it suggests that the intermediary will engage in a wholly separate transaction with the hotel, thus taking the focus off the amount paid by the transient. If such a second transaction takes place, the city argues, the intermediary must actually purchase the room license. However, the city points out, the OTCs do not purchase licenses and resell them. The city argues that the trial court was thus improperly branding the OTCs to be resellers.

We disagree with this logic. The ordinance contemplates that the room rental, paid to the hotel, may be paid by the transient or by a person or entity paying on behalf of the transient. That intermediary need not ever own the right to occupy the hotel room. Nor is there any suggestion that room rentals must be limited to a single transaction between the transient and the hotel. The tax is imposed on the amount "paid for room rental by or for any . . . transient." (§ 6.68.020.) This language allows for the use of the preferred merchant model. The transient pays a sum to the OTC, which takes its commission off the top then pays to the hotel the amount of "room rental" for the transient. It is the room rental, paid to the hotel, for the transient, that is taxable.[3]

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[3] The city expresses much concern throughout its briefs that the separate compensation paid to the OTCs is never fully set forth to the transient. Thus, the city complains, the OTCs and the hotels are hiding the tax base, which is unknown to the transient. However, as the city points out, the transient is made aware at the time of purchase that an amount for "taxes and fees" is being charged. As the city admits, this separately charged item conveys to the transient that taxes will be taken care of. The transient may have an incomplete understanding of the tax base, but the city has not been injured by any such obfuscation. The city has received TOT based upon the total amount

The city argues that the OTCs admit that their commission is taxable when the agency model and the modified merchant model transactions are used. Thus, the city argues, the OTCs "constructively admit" that the timing of the payment of their sales commissions should not affect the tax base. The city contends that the nature of a sales commission is not altered by the timing or method of its payment. Because the commission is taxed under the agency model and the modified merchant model, it should be taxable under the preferred merchant model.

Again, we disagree. In this case, the tax is levied on amounts paid by or for a transient to a hotel. If the OTCs' commission is taken before the room rental is paid to the hotel, it is not part of the taxable base. The city does not suggest that the preferred merchant model is illegal or that the hotels, which presumably agree to the structure of the transactions, are deliberately assisting the OTCs to avoid paying taxes. There is no suggestion that the amount the hotel receives is anything less than what it agreed to charge for the room rental. Because the TOT is based on the "total amount paid for room rental by . . . any . . . transient to any hotel," it does not include a commission that is extracted from the transient's payment before the room rental is paid to the hotel.

The city insists that "[a]ny side deal between the hotel and a transactional facilitator (e.g., an OTC) regarding payment of a sales commission is beside the point and does not alter the tax base." In support of this argument, the city cites *Groves v. City of Los Angeles* (1953) 40 Cal.2d 751 (*Groves*). In *Groves*, the Supreme Court discussed a tax on the gross receipts of every person in the business of furnishing bail bonds. The language of the statute mandated that every person in the business of """. . . soliciting, negotiating, effecting, issuing, delivering, or furnishing bail bonds . . . shall pay for each calendar year . . . a license tax . . .""" based on that person's gross receipts. (*Id.* at p. 753.) The question arose as to whether the gross amount received by an agent, who passed a portion back to the insurance company, was taxable. The court concluded that "the full sum received by [the agent] from the one desiring the bail bond is the gross

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paid for room rental on behalf of the transient to the hotel. The city's complaints on behalf of the transient do not affect our analysis of the plain language of the ordinance.

premium for the bond." (*Id.* at p. 760.) However, *Groves* is distinguishable because the statute at issue did not expressly limit the tax to the amount paid to the insurance company. The express limiting language in the city's TOT ordinance leads to a different result here.

The city next points to the language in the second sentence of section 6.68.010, subdivision (d), which defines "room rental." The sentence reads:

> "If the charge made by such hotel to such transient includes any charge for services or accommodations in addition to that of lodging, and/or the use of lodging space, then such portion of the total charge as represents only room and/or lodging space rental shall be distinctly set out and billed to such transient by such hotel as a separate item."

The city argues that under this language, the OTCs' sales commission would need to be separately stated if it is to be removed from the "total charge" and thus carved out of the tax base. This argument fails because, under the preferred merchant model, the OTCs' commission is not a charge "made by [a] hotel." It is a charge made by a third party intermediary that is not subject to the tax.

Finally, the city argues that the hotels benefit from the value of the OTCs' sales and marketing on their behalf. Citing *Interinsurance Exchange v. State Bd. of Equalization* (1984) 156 Cal.App.3d 606, 614 (*Interinsurance*), the city argues that such service fees should be taxable even though the hotel does not receive them. In *Interinsurance*, the Court of Appeal considered whether a $1 service fee charged for an installment plan of insurance, which was collected and retained by the Automobile Club of Southern California as agent for the Interinsurance Exchange, was taxable as part of the Interinsurance Exchange's "gross premiums." (*Id.* at p. 609.) In doing so, the court analyzed Insurance Code section 1530, which "defines the term 'gross premium' as including 'all sums paid by subscribers in this state by reason of the insurance exchange, whether termed premium deposit, membership fee, or otherwise . . . .'" (*Interinsurance*, at p. 610.) The court concluded that the $1 service fees were "unequivocally part and parcel to 'all sums paid . . . by reason of the insurance exchange.' (Ins. Code, 1530.)"

(*Interinsurance*, at p. 611.) Thus, *Interinsurance* demonstrates that it is the language of the statute that controls. The city's TOT does not purport to tax all sums paid by transients, regardless of how such sums are characterized. Instead, the tax is expressly limited to "the total amount paid for room rental by or for any . . . transient to any hotel." (§ 6.68.020.)

C. The city's agency arguments fail

The city next argues that even if the tax base is measured by the amount received by the hotel, the OTCs' commissions are included in that amount. The city argues that the OTCs function as the hotels' agents. Citing *Metropolitan Life Ins. Co v. State Bd. of Equalization* (1982) 32 Cal.3d 649, 660 (*Metropolitan*), the city concludes that "[w]hat the agent receives, in legal effect the [principal] receives."

The city cites Civil Code section 2295, which defines an agent as "one who represents another, called the principal, in dealings with third persons." The city argues that in preferred merchant model transactions, the OTCs' activities on behalf of the hotels -- promotion and sales of hotels' products -- fit precisely within Civil Code section 2295. The city argues that the OTCs are acting in a representative capacity and not on their own account. The city cites three cases in support of its argument that the OTCs are agents for the hotels.

First, the city cites *Scholastic Book Clubs, Inc. v. State Bd. of Equalization* (1989) 207 Cal.App.3d 734 (*Scholastic*). In *Scholastic*, the plaintiff was engaged in the interstate business of mail order book sales. It had no physical facility, bank account, or regular employees in California. It mailed catalogues to teachers and librarians, who passed on the catalogues to their students. The teachers then collected the orders and returned them to the company. Orders were filled and shipped from a Missouri warehouse. The plaintiff was assessed a use tax deficiency based on its California sales, paid under protest, then brought an action for a refund. (*Id.* at pp. 736-737.) To determine whether the tax was applicable, the *Scholastic* court analyzed the language of the relevant tax code, which taxed any "'retailer engaged in business in this state,'" defined as "'Any retailer having any representative, agent, salesman, canvasser, or

solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, or the taking of orders for any tangible personal property.' [Citation.]" (*Id.* at p. 737.) The court concluded that the teachers were acting under Scholastic's authority, "certainly as appellant's agents or representatives." (*Ibid.*)

Bank of America Nat'l Trust & Sav. Assoc. v. State Board of Equalization (1962) 209 Cal.App.2d 780 (*Bank of America*), and *Borders Online v. State Bd. of Equalization* (2005) 129 Cal.App.4th 1179 (*Borders*), set forth similar scenarios. In *Bank of America*, Bank of America allowed its customers to purchase checks manufactured by a non-California company called DeLuxe. Customers were able to order the checks through the bank, and the bank charged its customers for the cost of the checks plus an additional fee. (*Bank of America, supra*, at pp. 786-787.) Under this arrangement, the court held that Bank of America was "an agent for DeLuxe, an undisclosed principal." (*Id.* at p. 796.) Likewise, in *Borders*, an online bookseller utilized bookstores located in California to handle its product returns. (*Borders, supra*, at pp. 1184-1186.) The court concluded that the company that owned the California bookstores was an agent for the online retailer. (*Id.* at pp. 1189-1190.)

The OTCs argue that they do not act as agents for hotels. Unlike the entities found to be agents in the cases described above, the OTCs argue that they act in their own interest, rather than on the hotels' behalf.

We find that we need not determine whether or not the OTCs act as agents for the hotels. Even if the OTCs are agents, the city has not convinced us that the OTCs' commissions must be considered to be money "paid for room rental . . . to any hotel." (§ 6.68.020.)

In support of its argument that money received by an agent must be considered money received by the principal, the city relies mainly on one case, *Metropolitan, supra*, 32 Cal.3d 649. *Metropolitan* concerned employee group medical benefit plans provided by Metropolitan Life known as "Mini-Met" plans. (*Id.* at p. 652.) The Mini-Met plans were an alteration of Metropolitan Life's normal plans in that employers agreed to cover all employee covered medical claims up to a "trigger-point" amount. This arrangement

reduced premiums. (*Id.* at p. 653.) The Insurance Commissioner levied upon Metropolitan Life for unpaid taxes "based upon the sum of the amounts employers paid to Metropolitan as premiums plus the aggregate yearly claims paid to employees from employers' funds." (*Ibid.*) The issue was whether the "pretrigger-point claims payments, although financed by the employers, should be included within the total amount on which Metropolitan must pay a gross-premiums tax." (*Id.* at 659.)

The court began by noting that "[t]he California Constitution imposes a franchise tax 'on each insurer doing business in this state,' measured by the amount of 'gross premiums' which the insurer receives in a particular year. [Citations.]" (*Metropolitan, supra*, 32.Cal.3d at p. 652.) The question was whether the amounts that were never formally paid to Metropolitan should nevertheless be "included within the gross premiums measure of the tax imposed on its business done in California." (*Ibid.*) The court understood the appropriate inquiry to be "whether the purpose of the taxing provisions can best be fulfilled by including amounts paid on pretrigger-point claims within the gross premiums measure of Metropolitan's tax." (*Id.* at p. 656.) In determining the answer to this inquiry, the court analyzed the insurance arrangement. The court reasoned:

> "Metropolitan actually paid claims from the special accounts of the employers pursuant to authorization by the employers. Rather than paying the cost of group insurance directly to Metropolitan, these employers deposited the money into accounts under Metropolitan's control. The payments to employees from such accounts constituted an element of overall cost of the insurance package in the same manner as if those amounts had been paid to Metropolitan as 'premiums' then forwarded to the employees by Metropolitan in satisfaction of the employee claims. For the purpose of calculating the gross premiums tax, we can discover no reasoned basis for distinguishing between the situation here presented and the former arrangement between Metropolitan and the employers. Metropolitan continued to derive substantially the same benefit of doing business in California and should logically have continued to incur the same tax liability." (*Id.* at p. 657.)

The court concluded that the employers were working as agents of Metropolitan, and that Metropolitan was required to pay a gross-premiums tax on the pre-trigger point claims payments. The court discussed *Groves, supra*, 40 Cal.2d 751, and *Allstate Ins. Co. v. State Board of Equal.* (1959) 169 Cal.App.2d 165, to address "the more general question of what amounts are included within the meaning of the term 'gross premiums.'" (*Metropolitan, supra*, 32 Cal.3d at pp. 659-660.) Citing *Groves*, the court set forth the "'basic theory . . . that the amount paid by the insured for the insurance is the premium. . . . What the agent receives, in legal effect the insurer receives.'" (*Metropolitan, supra*, at p. 660.) From *Groves* and the other insurance cases, the court derived a "general rule that the insurer is to be assessed a tax based on the total cost of the insurance coverage provided to the insured." (*Metropolitan*, at p. 660.)

As with the other insurance cases cited by the city, we find that the holding of *Metropolitan* is limited to the insurance context and the specific laws associated with taxes on insurance premiums. The matter before us does not involve an insurance premium, and the language of the tax ordinance in question is expressly limited.

While it is true that in *Metropolitan* the employers were considered to be agents of the insurer, that was not the primary rationale for the court's finding that the pretrigger point claims payments should be included within the gross premium which the insurer received. The rationale was based on a close look at the arrangement, under which the employer and the insurer both had access to the funds, and the traditional view of the meaning of the term "gross receipts" in the insurance context. The city has provided no authority suggesting that this rationale has ever been applied outside of the insurance context. Nor does the city provide any authority for a broad conclusion that every penny an agent receives must legally be considered to have been received by the agent's principal.

We are presented with an ordinance that specifically limits the tax to "fourteen percent (14%) of the total amount paid for room rental by or for any . . . transient to any hotel." (§ 6.68.020.) A "hotel" is specifically defined as a "lodging place within the City of Santa Monica." (§ 6.68.010, subd. (c).) The taxable amount is the amount of money

paid to the hotel. While the cases cited by the city illustrate that in the insurance context, "the amount paid by the insured for the insurance is the premium" (*Metropolitan*, *supra*, 32 Cal.3d at p. 660), there is simply no room to interpret this TOT ordinance as reaching any amount other than that which is paid directly to the hotel.

Even if the OTCs are agents for the hotels, claims against an agent are limited to what the claimant is entitled to demand from the principal. "[A] claim under [Civil Code] section 2344 against the agent is limited to what the claimant is entitled to demand from the principal." (*Garrison v. Edward Brown & Sons* (1944) 25 Cal.2d 473, 482.)[4] The OTCs charge and retain their commissions for their own benefit, not for the benefit of the hotels. The hotels have no claim to the commissions. The city has not alleged that any hotel within the city is liable for the TOT assessed against the OTCs, or for any portion thereof. Because the city has no claim against the hotels -- the alleged principals -- the city has no claim against the OTCs. Under the circumstances, the city's agency arguments fail.

D. The step transaction doctrine is not relevant and does not change the result

The city urges this court to apply an analytical tool known as the "step transaction doctrine." (*Shuwa Investment Corp. v. County of Los Angeles* (1991) 1 Cal.App.4th 1635, 1647-1648 (*Shuwa*).) For the purposes of this argument, the city breaks down the preferred merchant model into four phases: (i) the transient pays all amounts ("room rate" plus "taxes and fees") to the OTC; (ii) the OTC then removes and retains the two components of its sales commission -- the contractually dictated portion of the "room rate" and the "fees" portion of "taxes and fees" -- and sua sponte an amount equivalent to TOT on its sales commission; (iii) the OTC then forwards the net-of-commission amount for the room license and TOT based on that net-of-commission amount, to the hotel; (iv)

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[4] Civil Code section 2344 provides: "If an agent receives anything for the benefit of his principal, to the possession of which another person is entitled, he must, on demand, surrender it to such person, or so much of it as he has under his control at the time of demand, on being indemnified for any advance which he has made to his principal, in good faith, on account of the same; and is responsible therefor, if, after notice from the owner, he delivers it to his principal."

the hotel then remits the quantum of TOT received from the OTC to the city. Each phase is dependent upon the others in sequence; they are mutually dependent and inherently intertwined steps in achieving the sale.

The city argues that, because the OTCs' commissions are part of the tax base in both the agency and modified merchant model transactions, they must also be part of the tax base under the preferred merchant model transactions. The city argues that the step transaction doctrine prevents transactional ordering to alter the amount of the tax base.

The step transaction doctrine was explained by the *Shuwa* court as follows:

> "In a case such as this, where the propriety and necessity for multiphase transactions is challenged, the 'step transaction doctrine' has been applied to determine whether the transaction should be treated as a whole or whether each step of the transaction may stand alone. The 'step transaction doctrine' is a corollary of the general tax principle the incidence of taxation depends upon the substance of a transaction rather than its form. [Citation.]"

(*Shuwa, supra,* 1 Cal.App.4th at p. 1648.)

In *Shuwa*, the court addressed a transfer of ownership of the ARCO Plaza in Los Angeles. Shuwa sought to acquire 100 percent ownership of the building, while limiting the legal "change in ownership" for property tax purposes to 50 percent. (*Shuwa, supra,* 1 Cal.App.4th at pp. 1640-1641.) The parties structured a three-step transaction to accomplish this goal. (*Id.* at pp. 1639-1643.) Applying the step transaction doctrine, the court found that "it appears the three steps were really component parts of a single transaction. The ultimate result intended from the outset was for Shuwa to acquire *all* of the ARCO Plaza from the present owner, a partnership." (*Id.* at p. 1651.) The court concluded that "the transactions in the case at bar should be stepped together to reveal what actually occurred -- the acquisition by Shuwa of 100 percent of the ARCO Plaza." (*Id.* at p. 1650.)

The *Shuwa* court explained that three independent tests govern application of the step transaction doctrine: end result; interdependence; and binding commitment. (*Shuwa, supra,* 1 Cal.App.4th at pp. 1650-1653.) The city argues that the OTCs'

preferred merchant model structure readily satisfies each of the three tests. Further, the city argues, independent business considerations do not justify the preferred merchant model structure. Because an alternative transactional structure exists -- the modified merchant model -- under which the integrity of the tax is preserved, the chosen multi-phase transactional structure must be viewed as a transactional manipulation to avoid tax liability.

We find that the step transaction doctrine is inapplicable. The *Shuwa* court quoted a leading United States Supreme Court case discussing this doctrine, *Gregory v. Helvering* (1935) 293 U.S. 465 (*Gregory*), which explained that the step transaction doctrine should be applied where "the transaction upon its face lies outside the plain intent of the statute." (*Id.* at p. 470.) Unlike the parties in *Shuwa*, the hotels and OTCs have not structured the preferred merchant model transactions for the purpose of avoiding tax liability. Nor do preferred merchant model transactions lie "'outside the plain intent of the statute.'" (*Shuwa, supra*, 1 Cal.App.4th at p. 1650.) The ordinance reveals an intent to tax the "amount paid for room rental by or for any . . . transient to any hotel." (§ 6.68.020.) The preferred merchant model is not structured to avoid paying such TOT.

The city argues that the step transaction doctrine is not focused on a series of sham transactions but on multi-phase transactions that should be considered as a whole in analyzing their overall tax effects. We disagree with this interpretation of the relevant case law. The transaction in *Gregory* was described as "an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else." (*Gregory, supra*, 293 U.S. at p. 470.) The language used by the court shows a focus on the fraudulent nature of the transaction, which "upon its face [lay] outside the plain intent of the statute." (*Ibid.*) The *Shuwa* court quoted *Kuper v. Commissioner* (5th Cir. 1976) 533 F.2d 152, 158-159 (*Kuper*), which stated "for this Court to permit taxpayers randomly to piece together the various provisions of the Code unhampered by any limits on the artificiality of their constructions would leave the Congressional[ly enacted] taxing scheme in shambles." The *Shuwa* court indicated that the series of transactions at issue in that case was similarly designed to improperly and artificially avoid tax. Thus, in order

for the step transaction doctrine to apply, it is necessary that the transactions at issue be designed as "'unacceptable artifice'" rather than "'valid tax planning.'" (*Shuwa, supra*, 1 Cal.App.4th at p. 1655, quoting *Kuper, supra*, at pp. 158-159.) No such devious intent is apparent in the structure of the preferred merchant model -- nor does it in fact avoid the payment of TOT.

In sum, the preferred merchant model does not consist of a series of sham transactions designed to avoid tax liability. There is no suggestion that any hotel or OTC participates in the merchant model transactions as a means to avoid paying TOT to the city. Nor has the city been harmed by any underpayments. Therefore, the step transaction doctrine is inapplicable.

IV. Because the TOT ordinance does not impose tax on the OTCs' commissions, the city's causes of action fail as a matter of law

We have determined that the city's TOT ordinance does not impose tax on the commissions that an OTC collects and retains prior to forwarding the amount of room rental to a hotel. As set forth below, the city's remaining claims against the OTCs fail under this interpretation of the ordinance.

In addition to its claim for violation of the ordinance, the city brought claims against the OTCs for money had and received; conversion; violations of Civil Code sections 2223 and 2224; imposition of constructive trust; declaratory relief; agents' liability under Civil Code sections 2343 and 2344; and breach of fiduciary duties. For the reasons set forth below, each claim must fail as a matter of law.

A. Money had and received/conversion

In its second cause of action for money had and received, the city alleged that the OTCs "have become indebted to the plaintiff City of Santa Monica for the assessed amounts plus interest and penalties since the dates of the assessments." The city has failed to allege any facts supporting such indebtedness on the part of the OTCs. As explained above, the OTCs had no obligation to remit to the hotel or the city TOT based on their commissions under the preferred merchant model. They were only required to

remit TOT based on the amount paid for room rental on behalf of the transient to the hotel. Having received this TOT, the city is not entitled to any further amount.

"'Conversion is the wrongful exercise of dominion over the property of another. The elements of a conversion claim are: (1) the plaintiff's ownership or right to possession of the property; (2) the defendant's conversion by a wrongful act or disposition of property rights; and (3) damages.' [Citation.]" (*Hernandez v. Lopez* (2009) 180 Cal.App.4th 932, 939-940.) In its third cause of action for conversion, the city alleged that it is the sole and rightful owner of the difference between the TOT due on the total charge for lodging and the TOT remitted by the OTCs to the hotels. Again, this theory of common law liability is premised on the theory that the OTCs were required to remit TOT on their commissions under the preferred merchant model. This premise is incorrect, and the city has alleged no facts suggesting that it has any right to possession of any converted property that the OTCs wrongfully possess.

The city has failed to allege facts sufficient to support its causes of action based on conversion and money had and received.

B. Violations of Civil Code sections 2223 and 2224

Civil Code section 2223 provides that "[o]ne who wrongfully detains a thing is an involuntary trustee thereof, for the benefit of the owner." Civil Code section 2224 provides that "[o]ne who gains a thing by fraud, accident, mistake, undue influence, the violation of a trust, or other wrongful act, is, unless he or she has some other and better right thereto, an involuntary trustee of the thing gained, for the benefit of the person who would otherwise have had it."

In its fifth cause of action for violation of Civil Code section 2223, the city alleged that the OTCs wrongfully detained funds due and owing to the city. The city further argued that "the OTCs collected from transients TOT on the total charge for lodging but retained a portion of such collections." The city made similar arguments in its sixth cause of action for violation of Civil Code section 2224. Under both causes of action, the city sought "appropriate legal or equitable remedies to prevent the unjust enrichment of the OTCs by causing payment to the City of all amounts wrongfully maintained in the

possession of the OTCs with appropriate interest, penalties, costs and fees, as allowed by law."

The city's argument is premised on its theory that TOT is owed to the city on the commissions retained by the OTCs prior to forwarding the room rental and TOT to the hotel. As we have discussed, this theory is not supported by the plain language of the ordinance. Under the ordinance, the city is only entitled to TOT on the total amount paid for room rental by or for a transient to a hotel. The city is not entitled to any money retained by the OTCs.

C. Imposition of constructive trust

In its seventh cause of action for imposition of constructive trust, the city alleged that "the TOT collected but not remitted by the OTCs belonged to the City and was in the possession and under the control of the OTCs. The OTCs have taken this property for their own use and benefit, thereby depriving the City of the use and benefit thereof." Again, this cause of action is based on the erroneous premise that the OTCs must pay TOT on their commissions under the preferred merchant model. The plain language of the statute undermines this position, and the cause of action must fail.

D. Liability as agents under Civil Code sections 2343 and 2344; liability as subagents under Civil Code sections 2349 and 2351

In its ninth cause of action, the city alleged that the OTCs acted as agents of the hotels. Therefore, the city alleged, "the OTCs' charge of the room rate to the transient is made on behalf of and is in fact the total charge made by the hotel for its room license." By virtue of their status as agents for the hotels, the city alleged, the OTCs have received money from transients for the benefit of the hotels, and the OTCs continue to improperly control money to which the city is entitled.

As set forth above, even if they are considered to be agents of the hotels, the OTCs have not acted improperly. The amount of TOT is calculated based on the amount paid for room rental on behalf of the transient to the hotel. Under the facts alleged, the OTCs have transmitted the room rental, plus the proper TOT on that amount, to the hotels. The

OTCs' commissions are not taxable, therefore the OTCs have not improperly retained any money belonging to the hotel or to the city.

The same analysis applies to the city's claims under its tenth cause of action for liability as subagents. The OTCs' commissions are not part of the taxable base amount. The OTCs have not wrongfully retained any money from either the hotels or the city. The causes of action based on agent and subagent liability thus fail as a matter of law.

DISPOSITION

The judgment is affirmed. Respondents are awarded their costs on appeal.

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS.

_____, J.
CHAVEZ

We concur:

_____, P. J.
BOREN

_____, J.
ASHMANN-GERST